

The leasing of tangible personal property by persons who are primarily engaged the business of selling such property at retail is within the interim use exemption if that property is carried as inventory on the books of the retailer or is otherwise available for sale during the lease period. See 86 Ill. Adm. Code 150.306. (This is a PLR).

September 7, 1999

Dear Mr. Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see enclosed), is in response to your letter of August 20, 1999. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of the enclosed copy of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

On behalf of our client, COMPANY (hereinafter "Lessor"), we hereby request a ruling concerning the application of Illinois sales and use taxes to the transactions described herein.

Facts

Lessor, a nationwide owner and lessor of motor vehicles, provides financing arrangements for consumers of leased vehicles through a network of unrelated motor vehicle dealers.

In the typical transaction, an unrelated dealer ("Dealer") purchases a motor vehicle from a manufacturer for resale and holds it in its sales inventory until it is sold or leased to a consumer. If the consumer decides to lease, Dealer enters into a lease with the consumer and immediately thereafter sells the vehicle and assigns the lease to Lessor.

Mechanically, the transaction involves the following steps:

- Dealer submits a credit application, filled out by the consumer, to Lessor;
- Assuming Lessor approves the credit, Dealer and the consumer execute a lease on a lease form provided by Lessor;

- Dealer does not pay sales or use tax on its purchase of the vehicle;

Dealer sells the leased vehicle and assigns the related lease to Lessor and pays the applicable sales tax to the Department of Motor Vehicles at the time of title registration. The initial title and registration of the vehicle are issued in the name of Lessor.

Dealer's purpose in leasing is to enhance its business of retailing vehicles, to produce sales income and not to derive rental income. Dealer does not transfer the car from its sales inventory to a leasing inventory, nor does Dealer depreciate the car for book or tax purposes. The lease document is drafted by Lessor and provided to Dealer, and states that the car and lease will generally be assigned to the Lessor simultaneously with execution of the lease by Dealer, pending acceptance by the Lessor. Lessor's typical agreement with dealers provides generally that, if the lease terms, consumer credit, type of automobile and residuals are in accord with Lessor's standards, Lessor will generally purchase the automobile subject to the lease, although it is not required to do so. Dealer never titles or registers the car in its own name, which would be required by Illinois law if the dealer held the vehicle for lease for any meaningful period.

It should be noted that Dealer is able to offer a number of financing sources, including Lessor, to any consumer that chooses to lease a vehicle. After one or more of these sources have approved the consumer's credit and all other aspects of the proposed lease arrangement, Dealer enters into a lease with the consumer and then sells the vehicle and lease to the accepting financing source. When Lessor is the financing source, Dealer's sale to Lessor occurs at such point in time as Lessor establishes that the lease and vehicle documentation are in accord with the credit approvals and the requirements of Lessor's agreement with Dealer. If there are discrepancies that cannot be rectified, the purchase and assignment are never consummated. Lessor may not originate leases directly with the consumer, as it is not licensed to do so.

Because titling and registration laws restrict the flexibility that would otherwise be available to Lessor as it attempts to access various funding sources, and creates inefficiencies and increased costs to consumers, Lessor is considering the use of a titling entity to purchase and hold title to leased vehicles.

Under the proposed structure, Lessor would create a business trust or a limited liability company ("Titling Entity") that would acquire legal title to the leased vehicles and related leases. The certificates of title to the leased vehicles would be issued in the name of Titling Entity and Titling Entity would become the lessor under the leases. The primary assets of Titling Entity would consist of i) the leased vehicles; ii) the leases; and iii) the proceeds of the foregoing. Lessor would be issued certificates of beneficial interest or stock representing its interest in Titling Entity and its assets.

Request for Ruling

We respectfully request that you rule as follows:

1. No Illinois ROT or Use Tax is imposed as a result of Dealer's entering into the lease with the consumer prior to selling the vehicle to Lessor or Titling Entity, since Dealer's use constitutes an exempt "interim use."
2. Illinois ROT and USE tax is imposed with regard to Dealer's sale of the vehicle and lease to Lessor or to Titling Entity.

Discussion

Illinois imposes Retailers' Occupation Tax ["ROT"] upon persons engaged "in the business of selling at retail tangible personal property." 35 ILCS 120/2. Illinois simultaneously imposes a complementary use tax upon the privilege of "using in this State tangible personal property purchased at retail from a retailer" in Illinois. 35 ILCS 105/3. The tax base for both of these taxes is a "sale at retail, which is defined as "any transfer of ownership or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property to the extent not first subjected to a use for which it was purchased, for a valuable consideration." 35 ILCS 120/1; 35 ILCS 105/2. Therefore, a sale for resale is not subject to ROT/Use Tax unless the purchaser first subjects the property to a use for which the property was purchased. Thus, in general, a retailer's use of property originally purchased for resale destroys the retailer's exemption and causes tax to apply to the retailer.

By statute and regulation, however, certain uses do not destroy the retailer's right to the resale exemption. For this purpose, "[u]se" does not mean the demonstration use or interim use of tangible personal property by a retailer before he sells that tangible personal property." 35 ILCS 105/2.

Department regulations make clear that an "interim use" does not terminate the retailer's resale exemption. "Tangible personal property . . . used by the retailer or his agents prior to its ultimate sale at retail, is exempt . . . provided that the tangible personal property is carried as inventory on the books of the retailer or is otherwise available for sale during the interim use period," 86 Ill. Adm. Code § 150.306(1), and as long as the retailer is not actually a person who purchases the property "with the intent to engage in the business of leasing such property and who sell[s] such property only as an incident to their leasing activity." 86 Ill. Adm. Code § 150.306(2).

Under either scenario, Dealer is primarily engaged in the retail sale of vehicles and its leasing activity is, in the words of the regulation, "incident to" the retailer's retailing activity, and not vice versa. Dealer at all times carries the vehicle on its books as sales inventory, and does not depreciate the car for book or tax purposes. Dealer actually receives no rental income. As a retailer, Dealer's purchase of vehicles from the manufacturer is exempt from taxation as a sale for resale. As a result, Dealer's lease of

the vehicle in anticipation of sale to Lessor or to Titling Entity qualifies as an "interim use" of the vehicle, with the result that Dealer owes no tax as a result of its lease of the vehicle.

The sale of the vehicle by Dealer to Lessor or to Titling Entity is a "sale at retail" subject to ROT and Use Tax, since no resale or other exemption is applicable on the facts presented.

We respectfully request confirmation of these conclusions in a ruling. The undersigned is not aware of any authorities contrary to these conclusions. Neither an audit nor litigation related to these matters is pending with the Illinois Department of Revenue.

We enclose a Power of Attorney authorizing the undersigned to represent Lessor in this matter. If a disposition other than a favorable ruling is contemplated, a conference is requested.

Your consideration of these issues is appreciated. If additional information is needed, please do not hesitate to contact me at #####.

We are assuming that the leases referenced in your letter are true leases (not conditional sales) and that the leases are not subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq. We are answering some of your questions in Section 1 of this letter that concern persons, such as the motor vehicle dealers, who are not a party to this Private Letter Ruling, in order to provide you with a complete answer. This Private Letter Ruling is not binding on the Department with respect to these other persons. It will only bind the Department with respect to COMPANY for the issue or issues regarding it that are presented in this ruling. Section 2 contains a response to the issues that pertain to the tax liabilities of your client, COMPANY.

SECTION 1

For purposes of responding to your question regarding the dealers entering into leases and the dealers' sales of those leases to a titling entity, the nature of your question and the information you have provided require that we respond in the context of a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed. So that you may avoid having to send a follow up letter, we are answering Section 1 of this letter in the format of a General Information Letter.

If leases are executed between the vehicle dealers, as lessors, and the applicants, as lessees, the dealers are acting as lessors of the leased vehicles. Absent a valid exemption, the dealers incur Use Tax liability based on their cost price of those vehicles. Since the dealers are considered the end

users of the vehicles and incur the Use Tax, no Retailers' Occupation Tax is imposed upon the lease receipts and the lessees incur no Use Tax liability for the lease charges.

If the dealers do not know at the time of purchase of a specific vehicle whether it is to be resold or leased, the dealers may provide a blanket Certificate of Resale to the manufacturer. See subsection (c) of the enclosed copy of 86 Ill. Adm. Code 130.1405. However, when it is determined that the vehicle is going to be leased instead of resold, the dealer must self assess the appropriate amount of Use Tax on the cost price of the vehicle and remit that amount directly to the Department unless a valid exemption may be claimed by the dealer.

Tangible personal property purchased by a retailer for resale, and used by the retailer or his agents prior to its ultimate sale at retail, may be exempt from Use Tax under the interim use exemption. The leasing of tangible personal property by persons who are primarily engaged in the business of selling such property at retail is within the interim use exemption if that tangible personal property is carried as inventory on the books of the retailer or is otherwise available for sale during the lease period. See the enclosed copy of 86 Ill. Adm. Code 150.306 (a)(2). Generally, motor vehicle dealers who enter into leases of motor vehicles under the above circumstances in order to make a contemporaneous sale of those vehicles, may claim the interim use exemption.

Please note that when motor vehicle dealers sell motor vehicles for which those dealers are claiming the interim use exemption, those sales are sales at retail and are subject to Retailers' Occupation Tax liability on the gross receipts from such sales. Likewise, the purchasers incur Use Tax liability on the purchase price of the motor vehicles. This is true regardless of whether the purchasers are persons, corporations, limited liability companies, partnerships or other legal entities, including valid trusts operating under the Illinois Trust and Trustees Act. 35 ILCS 760/1 et seq. (1996 State Bar Edition).

SECTION 2

For purposes of responding to your question regarding the sale by the dealers of leased vehicles to COMPANY, we are responding in the context of a Private Letter Ruling that is binding upon the Department.

The sale to COMPANY by a dealer of a motor vehicle that is encumbered by a lease is a retail sale by that dealer. In that instance, the dealer incurs Retailers' Occupation Tax liability on the gross receipts from that sale and the purchaser, COMPANY will incur a Use Tax liability on the purchase price of that motor vehicle.

Your letter indicates that the lease will generally be assigned simultaneously with the execution of the lease by the dealer. Your letter does not provide any specific information about the assignment of the lease. I have enclosed a copy of 86 Ill. Adm. Code 130.220 for your general information. Please note that all gross receipts received from the sale of tangible personal property at retail, whether or not encumbered by leases or other rights vested in third parties, are presumed to be subject to Retailers' Occupation Tax Liability. See subsection (a) of Section 130.220. If you need

specific information about the taxability of the assignments of the leases, you will need to send us specific information regarding those assignments.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Terry D. Charlton
Associate Counsel

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